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No. 93-1787

In the Supreme Court of the United States

OCTOBER TERM, 1994

FIDELITY AND DEPOSIT COMPANY OF MARYLAND,
PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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14 pp

QUESTIONS PRESENTED

1. Whether, on the facts of this case, the 1986 surety bond that petitioner issued is enforceable by the United States.

2. Whether summary judgment was appropriate in this case.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A13) is reported at 10 F.3d 1150. The opinion of the district court (Pet. App. D1-D11) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on January 7, 1994. A petition for rehearing was denied on February 7, 1994 (Pet. App. B1). The petition for a writ of certiorari was filed on May 9, 1994. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The United States imposes an excise tax on the production of distilled spirits. The operator of a distillery is required to secure the payment of those taxes with surety bonds. The tax attaches to the production of the spirits and is to be paid before the spirits may be removed from the plant. 26 U.S.C. 5001(b), 5213. In some circumstances, however, the taxes may be paid on semi-monthly returns instead of on each shipment separately.

The proprietor of a distilled spirits plant is required to obtain an "operations bond" prior to commencing operations. 26 U.S.C. 5173(a)(1). The operations bond secures taxes on all distilled spirits located at the distillery and on all distilled spirits improperly removed from the distillery's premises. 26 U.S.C. 5005(c). Distilled spirits may not be removed from the bonded distillery premises except upon prepayment of the distilled spirits excise tax unless the proprietor has obtained a "withdrawal bond." 26 U.S.C. 5173(a)(2). The withdrawal bond allows the proprietor to defer payment of the taxes until the due date of the semi-monthly return. The proprietor also has the option of obtaining a "unit bond," which provides coverage for both operations and withdrawal activities. 26 U.S.C. 5173(d). When a unit bond is chosen, the total amount of a unit bond is available for satisfaction of any distilled spirits tax liability, whether based on operations or on withdrawals. 26 U.S.C. 5173(g). If production or withdrawals for any period exceed bond coverage, the distillery may obtain a "strengthening bond" from the surety to increase the coverage. 27 C.F.R. 19.245, 19.246. During the period relevant to this case, the Treasury Department's Bureau of Alcohol, Tobacco and Firearms (ATF) regulated the operations of distilleries and, in conjunction

with the Internal Revenue Service, monitored their tax returns and tax payments.

2. Petitioner is a commercial bonding company. In October 1984, petitioner issued a distilled spirits bond to secure the federal excise tax obligations of Bay River, a distilled spirits bottler. On the front of the bond form, indicating the "type of bond as prescribed under 26 U.S.C. 5173," the boxes for "Withdrawal bond" and "Unit bond" were checked. The "operations bond" box was not checked. In the block imprinted "Amount of bond," the amount "$350,000" was typed. On the reverse side of the bond form, a line was filled out indicating that Bay River Company had operations coverage in the amount of $250,000 and withdrawal coverage in the amount of $100,000 (Pet. App. A3-A4, D2-D3; Appellant's Record Excerpts, Tab 6). That coverage allocation is consistent with the requirements for a unit bond. 27 C.F.R. 19.244.

Bay River began operations in November 1984. Regular ATF audits began in April 1986. The first two audit reports indicated that Bay River had poor internal controls and cash flow problems but that its proprietor was cooperating and was trying to make improvements. Each report recommended close scrutiny of Bay River's operations and tax returns (Pet. App. A4).

Two checks for January 1986 excise taxes were returned to the Internal Revenue Service (IRS) unpaid. In February 1986, ATF notified Bay River pursuant to 27 C.F.R. 19.519 (1986) that its taxes would have to be prepaid before spirits could be removed from the premises. By October 1986, ten more checks issued by Bay River were returned to the IRS unpaid. The ATF therefore notified Bay River that its tax prepayments must be made by cash, cashier's check, treasurer's check, or money order (Pet. App. A4).

3. In November 1986, petitioner issued a strengthening bond obligating itself for an additional $600,000 for withdrawal coverage in the event of any default by Bay River in payments of excise tax. In deciding to issue the strengthening bond, petitioner concluded that the bond would be written "on a full collateral basis" (Appellant's Record Excerpts, Tab 8 at 17). As security for the strengthening bond, petitioner obtained indemnification agreements from Stephen Fuller (president of Bay River) and letters of credit issued by American Bank and confirmed by Texas Commerce Bank (*id.* at 14). Petitioner did not contact the United States or its representatives concerning Bay River's financial situation. Instead, petitioner "relied on financial statements furnished by Bay River, which later proved to be inaccurate" (Pet. App. A4-A5).

Eighteen months later, after two more checks from Bay River were returned unpaid, and after a return was filed without an accompanying tax payment, ATF made demand on both Bay River and petitioner for unpaid excise taxes. Petitioner paid $100,000 pursuant to the original 1984 bond but denied further liability. Petitioner claimed that the document constituted two bonds: an operations bond of $250,000 and a withdrawal bond of $100,000. Petitioner asserted that its liability was limited to the withdrawal coverage of $100,000. With respect to the 1986 strengthening bond, petitioner claimed that the United States was estopped from enforcing it because ATF had not volunteered information to petitioner concerning Bay River's financial difficulties before petitioner issued the bond (Pet. App. A5 & n.2).

4. The United States then commenced this action against Bay River and petitioner. A default judgment was entered against Bay River for the unpaid distilled

spirits taxes. The district court also entered summary judgment against petitioner for the amounts of its surety bonds. The court concluded that the original 1984 bond was both a unit bond in the amount of $250,000 and a withdrawal bond in the amount of $100,000. Since the full amount of a unit bond is available for withdrawal liabilities, the court held that petitioner was liable to the government for the full $350,000 amount of the original 1984 bond (Pet. App. A5-A6, D5-D9).

With respect to the 1986 strengthening bond, the district court concluded that, since petitioner had relied on other assurances and had never requested any financial information from the government, the government's silence with respect to the financial difficulties of Bay River did not constitute a basis for an estoppel. The court held that, under the express terms of the strengthening bond, petitioner was liable to the United States in the amount of $600,000 (Pet. App. A6, D9-D12).

5. The court of appeals affirmed (Pet. App. A1-A13). The court concluded that the original 1984 bond was not a unit bond in the amount of $250,000 and a withdrawal bond in the amount of $100,000 but was instead a unit bond in the amount of $350,000. The court held that, reading the instrument as a whole, the box marked "withdrawal bond" on the surety form was surplusage (Pet. App. A8). The court of appeals therefore concluded that petitioner was liable for $350,000 for the original 1984 bond, less the $100,000 previously paid (Pet. App. A9).

With respect to the 1986 strengthening bond, the court of appeals held that, under federal law, the United States does not owe any implied duty of disclosure to a surety on an excise tax bond (Pet. App. A13). Since no express disclosure requirement existed under the strengthening bond, the court held that petitioner was obligated by its

terms to the United States in the amount of $600,000 (*ibid.*).

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or of any other court of appeals. Further review is therefore not warranted.

1. The court of appeals correctly held that petitioner was not relieved of its liability under the 1986 strengthening bond. The federal statutes and regulations that govern distillery bonds place no duty on the United States to volunteer information to sureties. See 26 U.S.C. 5001 *et seq.*; 27 C.F.R. 19.231 *et seq.* The language of the bond also does not require the government to reveal any tax or financial information to the surety.[1] And, petitioner never requested such information from the United States. Instead, petitioner chose to rely on the assurances and "full collateral" that it obtained from other parties (Pet. App. A4-A5; Appellant's Excerpts of Record, Tab 8 at 17).

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[1] As the court of appeals correctly concluded, petitioner errs in asserting (Pet. 5-6) that the decision in the present case conflicts with *St. Paul Fire & Marine Insurance Co.* v. *Commodity Credit Corp.*, 646 F.2d 1064 (5th Cir. 1981). In the *St. Paul* case, the bond at issue explicitly required the government promptly to notify the surety of any default. *Id.* at 1070. No such requirement exists in the bonds at issue in this case.

Similarly, petitioner errs in asserting (Pet. 10-15) that the alleged negligence of ATF agents in collecting taxes due could provide a defense to enforcement of the bonds. As this Court noted in *Hart* v. *United States*, 95 U.S. 316, 318 (1877), the United States "never becomes bound to others for the consequences of [the negligence of its officers], unless it be by express agreement to that effect."

Soliciting such information from the United States would have been improper in any event because the Internal Revenue Code prohibits officers and employees of the United States from revealing "return information" of any taxpayer to third parties. 26 U.S.C. 6103 (1988 & Supp. IV 1992). The term "return information" is broadly defined to include any information gathered by the Treasury Department concerning a taxpayer's liability under the Internal Revenue Code. See 26 U.S.C. 6103(b)(2)(A); *Church of Scientology of California* v. *IRS*, 484 U.S. 9, 13-15 (1987). Since the Treasury Department collects distilled spirits taxes and requires surety bonds under the provisions of the Internal Revenue Code, information gathered by ATF concerning defaults in distillery excise tax payments would ordinarily constitute "return information" protected by 26 U.S.C. 6103. See *Ryan* v. *Bureau of Alcohol, Tobacco & Firearms*, 715 F.2d 644 (D.C. Cir. 1983). In particular, the government may not disclose a distiller's payment history or other financial information obtained in an ATF distiller's audit. The government is permitted to disclose return information to the taxpayer's designee pursuant to the taxpayer's written consent. 26 C.F.R. 301.6103(c)-1(a). Petitioner made no effort, however, to obtain such written consent from Bay River.

2. State common law principles of suretyship also do not relieve petitioner from its liability on the 1986 strengthening bond. In the first place, federal, rather than state, law controls the enforcement of distilled spirits bonds. See *United States* v. *Fulton Distillery, Inc.*, 571 F.2d 923, 926-927 (5th Cir. 1978), citing *Clearfield Trust Co.* v. *United States*, 318 U.S. 363 (1943). The surety bond is mandatory under federal law. 26 U.S.C. 5173. Its terms are established by federal law.

The cause of action to enforce the bond is authorized by federal law. See 26 U.S.C. 7401; 26 U.S.C. 5173. Moreover, petitioner's basic complaints are that federal officials were not performing their governmental duties properly in regulating the distillery and that federal employees should disclose information otherwise protected by federal statutes (Pet. 10-15). See note 1, *supra*. There is a significant federal interest in establishing national rules of decision to avoid the "exceptional uncertainty" (*Clearfield Trust Co.* v. *United States*, 318 U.S. at 367) that would result from application of divers state laws to the rights and duties of the United States under these tax bonds.[2] See generally *United States* v. *Kimbell Foods, Inc.*, 440 U.S. 715, 726-727 (1979).

Petitioner has erred, in any event, in its reliance (Pet. 5-6) on the common law principle of suretyship found in Restatement of Security § 124 (1941). That principle requires a creditor to inform the surety of facts material to the surety's obligation if the creditor "has reason to believe that those facts are unknown to the surety" and if the creditor "has a reasonable opportunity to communicate them to the surety." *Ibid.* This provision of the Restatement seeks to incorporate the fraud defense of contract law to the suretyship contract. Restatement of Security § 124, Comment (a). The rule "does not place any burden on the creditor to investigate for the surety's benefit * * * [or] require the creditor to take any

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[2] This case differs markedly from *O'Melveny & Myers* v. *FDIC*, 114 S. Ct. 2048 (1994). In that case, this Court held that state rules of decision appropriately govern state law tort claims in cases where the FDIC succeeds to the rights of a failed private institution. In the present case, the rights of the United States are those of a direct beneficiary under a bond required by federal law, not merely those of a successor in interest to the state law claim of another party.

unusual steps to assure himself that the surety is acquainted with facts *which he may assume are known to both of them.*" Restatement of Security § 124, Comment (b) (emphasis added). There is nothing in the record to suggest that any government officer knew that Bay River had supplied petitioner with false information about its financial position. Moreover, petitioner never requested any information from the government concerning the issuance of the strengthening bond. Even if the Restatement applied to this case, it would thus provide no defense to petitioner's liability under the bond.

3. As the courts below recognized (Pet. App. A9-A13), the claim of estoppel was insufficient in this case because petitioner did not establish that petitioner reasonably relied on any conduct of the government. To the contrary, petitioner appears to have relied on the assumption that its undertaking was fully collateralized by third parties. See page 4, *supra*. Petitioner had avenues available to it to evaluate the risk of issuing a strengthening bond that it simply did not pursue. Petitioner cannot credibly contend that it relied on the absence of information from the government when it never sought such information and when the disclosure of such information would not be permitted by federal law. See pages 6-7, *supra*.[3]

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[3] Petitioner incorrectly contends (Pet. 7) that the rejection of its estoppel claim in this case is inconsistent with *Lyng* v. *Payne*, 476 U.S. 926 (1986). In *Lyng*, the Court concluded that a claim *in addition to* estoppel was present in that case. See *id.* at 936. In this case, by contrast, the court of appeals fully considered and properly rejected on the merits each of the separate claims that petitioner raised, including its claim of estoppel.

4. Petitioner asserts that the construction of the terms of the original bond was inappropriate for summary judgment because a genuine issue of material fact exists as to whether the bond was a unit bond or a withdrawal bond. But petitioner has alleged no specific facts relating to the issuance of the bond to support that contention. The interpretation of the language of the bond therefore presented a question of law for the court. Summary judgment was therefore proper in this case. See, *e.g.*, *Anderson* v. *Liberty Lobby, Inc.*, 477 U.S. 242, 256-257 (1986).

The district court and the court of appeals both concluded that the original bond was unambiguous and could be interpreted as a matter of law. The mere fact that the parties disagree as to the proper meaning of a contractual provision does not make the language of that agreement ambiguous. See *D.E.W., Inc.* v. *Local 93*, 957 F.2d 196, 199 (5th Cir. 1992). The inherently factual question whether this particular agreement was, or was not, ambiguous presents no conflict of decisions and does not warrant further review by this Court.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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